Start early, start young

By Kajal Dhaneshwari

Did you know in Canada, November is the month of financial literacy?

This November 2020, Canada is celebrating its tenth anniversary of its annual Financial Literacy Month.

Due to COVID-19, many Canadians, especially young adults, are struggling financially. Hence, this month, the Financial Consumer Agency of Canada (FCAC) aims to teach Canadians how to manage their finances in challenging times.

The knowledge, skills, and confidence to make informed decisions about the financial products and services that best meet people's needs underline the definition of financial literacy.

The unprecedented times which we are experiencing due to the global pandemic has come unexpectedly. So does financial emergencies, especially now.

During such times, savings and investing money provides financial security.

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5 tips for young adults to wisely save up money at a young age provided by *Komal Sandhu*, a

Financial Consultant.

An independent broker and insurance agent Pankaj Patel shares, "when you are young, you have countless liabilities, and they decrease as you grow old."

Hence, it is important to learn how to wisely make use of your hard-earned money at a young age.

Patel says, "if you don't know how to earn money, learn how to wisely manage the money you have.” Though the question remains, 'where do we start?'

savings and investments. (*Image provided by Pankaj Patel*).

Risk management

For young adults with less than bare minimum knowledge about financial literacy, he recommends starting at risk management.

Considering your risks mean understanding that life is not guaranteed. Accidents, diseases, and unexpected events can occur anytime. Any of these three situations and more can take away your ability to earn.

Risk management also involves managing your debt, securing emergency funds, and legal documentation of your will.

Now, how do you manage your risk?

Financially secure your life by investing in life insurance(s). To invest properly is the key to ensure any risks – which take away your ability to earn in the future – are covered. That includes critical illness and disabilities.

There are two types of life insurance in Canada: term insurance and permanent insurance also referred to as “whole life insurance.”

Term Insurance

"Term insurance is like renting a house. It just covers a need," says Briggette Ang, an independent financial broker in Edmonton. In other words, it is economically affordable.

In a term insurance policy, you pay a premium for a specified term of years. If the individual dies during that period, a death benefit is delivered to the insured's beneficiary. A beneficiary is a person whom the insured nominates to receive the death benefit compensation.

Permanent Insurance

"Permanent insurance is like buying a home," explains Ang. It covers you for life.

There are two types of permanent life insurance: universal life and participating life.

Patel mentions that in a participating life policy, the money an insurance company makes through its profits is paid to the insured, referred to as dividends. It is distributed annually during the span of the policy.

Universal life insurance provides investment savings opportunity, enabling cash value build up over time. Along with that, you only pay the low minimum premium payment required for the policy.

Usually, permanent insurance costs are guaranteed to stay the same from when you first purchased the policy. Most policies let you pay for a particular amount of time, and then you may choose to stop.

Permanent insurance assures the protection of your family, cover your funeral costs, and allow you to make plans for your estate.

Diwakar Gulia, 24, is an international student at NAIT who says, "in Canada, I don't earn enough to purchase life insurance at the moment due to rent, university fees and grocery expenses."

Though Gulia shares that he understands the importance of having a life insurance because he used to have one in India.

"I always keep three times the monthly salary I earn in my bank for emergency purposes as an alternative," shares Gulia.

Build your net worth

The second step is to build your net worth, which is done by investing the money you earn. To invest is to expend money with an expectation to have it grow so that profits can be received.

What better way is there to increase your net worth than investing in a Tax-Free Savings Account (TFSA).

TFSA

The TFSA program was initiated in 2009 to allow anyone 18 and older with a valid social insurance number to invest tax-free money.

Gulia says, "my uncle told me about TFSA a while ago and I have booked an appointment with a financial advisor to learn how I can invest in it.”

When asked why he is interested in investing in TFSA, he says, “because any amount contributed in the TFSA is not deductible for income tax, even when it is withdrawn."

“I like that kind of financial freedom, especially when you’re living alone in a new country,” added Gulia.

In 2020, the annual TFSA dollar limit is $6,000, which means $500 maximum per month. If you exceed the contribution limit of $6,000, a tax charge of 1 per cent per month will be applied.

For someone who has not invested in TFSA since it started in 2009, for example Gulia, you can contribute a maximum of $69,500 in total. If you don't use the annual limit, it gets carried over to the next year.

Gulia says, “even though my expenses are far greater than my savings, I appreciate there being a tax-free money growing option available, particularly during COVID.”

You can also designate your spouse as a success holder and any other person as a beneficiary. Upon death, you can transfer TFSA assets to a beneficiary, tax-free.

The five vehicles you can use to invest in TFSA are cash, savings accounts, a guaranteed investment certificate (GICs), the stock market, and mutual funds.

Cash

Cash is a no-interest investment with a low growth rate.

Savings-account

A savings account is an interest-based, no-risk investment with a growth rate of less than 2 per cent.

Ang says, “the inflation rate is 3 per cent currently, so you are actually losing money through a savings account because growth rate will be much lower.”

GICs

GICs are safe and low-risk investments that pay a lower rate of return compared to other vehicles. Though it guarantees a rate of return for a fixed period.

There may be an option available to get a higher return rate if you tie your money up for the period.

Stocks, equities and bonds

These three vehicles are a high-risk investment because, depending on the stocks, the fluctuation rate is high. But it provides the highest opportunity for growth.

Gulia says, “I want my money to grow because I do have my expenses on mind regularly though it is not worth taking the kind of stress that comes with investing in stocks.”

According to an article published on Nerd Wallet, 6 per cent is the annual average return rate depending on how much risk you are willing to take while investing.

Mutual Funds

Mutual funds are popular segregated low-to-high risks investment funds. They can consist of stocks, bonds, or commodities. Mutual funds also provide a medium-to-high opportunity for growth.

In this type of investment, an investment company manages your money based on their expertise to ensure you receive the best return.

The best aspect of mutual funds is the ability to make a pre-authorized contribution. For example, you can invest weekly, bi-weekly, or monthly.

Patel recommends young adults to commit to pre-arranged contributions.

Growth Diversification

Step three of financial literacy is growth diversification. Practice wise saving habits and be consistent with your money. Patel advises to "not get stuck in one place with your money."

Explore new ways to wisely grow your money in different sectors that help your future.

Lastly, all three financial literacy steps add up to building an estate, which can be inherited by your loved ones after you.

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5 common mistakes that young adults make when it comes to money provided *by Komal Sandhu*, a Financial Consultant.

COVID has made everyone look at their financial situation in a different light. For more information, click here.

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